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UNCLAS SECTION 01 OF 02 PRAGUE 000258

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SUBJECT: CZECH REPUBLIC: IMPACT OF RISING FOOD PRICES

REF: A. PRAGUE 254

1B. PRAGUE 35

11. SUMMARY AND COMMENT: The Czech Republic, like the rest of Europe, is experiencing a significant rise in food prices but at a higher rate than the average reported by the EU-27, and this phenomenon is contributing to the country's record inflation level of 7.5%. Czech nominal crops output prices increased 24.7% from 2006 to 2007, compared to the average EU-27 increase of 12.5%, making it the seventh highest in the EU after Romania (34.5%), Bulgaria (33.8%), Hungary (32.4%), Denmark (28.6%), Latvia (26.6%), and Lithuania (26.2%), according to Eurostat. Despite the rising food costs, Czech producer and consumer behavior has not yet changed, and there have not been any public protests or violence. General public discontent, especially among the significant number of pensioners in this fast-aging European country, has been about the general rise in the cost of living, which includes but is not exclusive attributed to food prices. On average, Czechs spend approximately 30% of their disposable income on food, compared to the EU average of 10 - 15%, and the figure is declining.

12. SUMMARY AND COMMENT CONTINUED: The Czech Association of Food and Beverage Producers attributes the rise in food prices primarily to increasing feed, fertilizer, energy and labor costs. Secondly, the Association believes food price increases reflect Czech price convergence with the rest of Europe, as well as the impact of increasing agricultural land use for biofuels. While the Czech supply chain and stocks of food and agriculture commodities remain stable, the Czechs may use this opportunity to get Brussels to lower their renewable energy target levels. As reported in ref A, the Czechs recently committed to increasing its renewable energy target from 8% to 13% by 2020 as part of the EU climate change policy. However, the Czechs realize this target is unrealistic and are looking for a way to renegotiate with Brussels, and the growing concern about rising food prices and the resulting discussion about the wisdom of increased EU biofuel targets provides a convenient opportunity. END SUMMARY AND COMMENT.

ALL FOOD PRICES RISING EXCEPT FOR PORK, BEEF, VEGIES

13. Nominal agriculture producer prices increased 26.1% and industrial producer prices increased 5.3% from March 2007 to March 2008, according to the Czech Statistical Office. A further breakdown by category is provided below and additional data is available in English on the Czech Statistical Office website www.csu.cz. Milk, wheat, pork,

and poultry are the most important foods consumed in the Czech Republic. In general, the Czech Republic exports raw food materials and imports value-added food products. 90% of trade is within the EU-27.

Among agriculture products,

- Crop product prices rose 34%, mainly due to higher prices of cereals (55%) and oil plants (60.5%)
- Fruit prices rose 35.9%
- Milk, eggs, and poultry prices rose 28.5%, 21.6%, and 20%, respectively
- Animal product prices rose 16.3%
- Potato and vegetable prices fell by 44.6% and 11.3%, respectively
- Pork and beef prices decreased 1.2% and 3.4%, respectively

Among industrial products, "food products, beverages and tobacco" rose 10.8%, of which,

- "Dairy products and ice cream" prices rose by 17.3%
- "Prepared animal feed" rose 35.6%
- "Other food products" rose 8.6%

¶4. January 2008 inflation data from the Czech Statistical Office revealed that CPI inflation hit 7.5% year-on-year, the highest inflation rate since November 1998 and the fifth highest among EU member states. During the month of January, CPI inflation rose 3% due to increase in the lower VAT rate from 5% to 9% for food and drugs, 9.6% rise in electricity prices, and a 18.9% jump in state-controlled rents. The Czech National Bank characterized the spike as a temporary swing sparked by tax changes, increase in regulated prices (electricity, gas, housing services), and "extraordinary growth in food prices." With its inflation-targeting policy, the CNB predicts inflation to ease back to 5.3% by Q4 2008 and 2.4% by Q2 2009.

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LITTLE CHANGE IN SUPPLY, DEMAND, OR GOVERNMENT POLICY

¶5. In terms of consumer demand, some economists believe the rise in food prices resulted in stagnation of food sales in November and December 2007. However, the Association of Food and Beverage Producers report that consumer behavior has not changed in quantity and selection (i.e., no substitution effect). On the supply side, cereal farming area has increased in response to the rise in food prices; the total area for wheat production has increased 5% from 2006 to 2007.

¶6. The Czech government has neither engaged in much discussion nor initiated a policy response to the increase in food prices. According to the Association of Food and Beverage Producers, most of the discussion on the topic has been at the EU-level in Brussels. The main concern for the Association is the "sandwich effect" felt by food producers as retail stores (supermarkets) seek lower prices and farmers are increasing their prices to reflect the rise in feed, fertilizer, and energy costs. EU biofuel targets are expected to have significant impact on feed but not food in the Czech Republic.
Grabner